

TO: Board Members

THROUGH: Jeff Walker, Executive Administrator
Amanda Lavin, Assistant Executive Administrator and Development Fund Manager
Rebecca Trevino, Chief Financial Officer

FROM: David Duran, Manager, Debt & Portfolio Management

DATE: August 18, 2016

SUBJECT: Briefing and discussion on the bond sale results for State of Texas, General Obligation Water Financial Assistance and Refunding Bonds Series 2016B, 2016C Economically Distressed Areas Program and 2016D State Participation Program totaling \$149,540,000

ACTION REQUESTED

No action is requested. This is a briefing and discussion on the results of the issuance of the referenced bonds.

BACKGROUND

The Water Financial Assistance and Refunding bonds, Series 2016BCD closed on July 14, 2016, providing proceeds of \$52,740,299 for projects and refunding \$114,180,000 of the Texas Water Development Board's (TWDB) bonds to generate total net present value savings of \$19,657,172.

On February 2, 2016, the TWDB authorized the Executive Administrator (EA) to prepare for the issuance of up to \$160,000,000 in Water Financial Assistance and Water Financial Assistance Refunding Bonds. Proceeds of the issuance were authorized to provide funds for loans under the TWDB's Water Development Fund (DFund) program, state match requirements for both the Clean Water (CW) and Drinking Water (DW) State Revolving Fund (SRF) grants, and to refinance callable Water Financial Assistance Bonds, including Economically Distressed Areas Program (EDAP) and State Participation Program (SP) Bonds. At the March 21, 2016 Board meeting, the TWDB approved the selection of the underwriting syndicate and at the June 1, 2016 Board meeting, the TWDB approved the transaction by resolution.

To maximize savings and reduce costs of issuance, the refunding and new money bonds were combined into a single transaction sold under one Preliminary Official Statement, and issued in various Subseries to accommodate differences in structure and tax status. FirstSouthwest, a Division of Hilltop Securities, Inc. served as financial advisor. Bracewell LLP served as bond counsel and Mahomes Bolden PC served as disclosure counsel. J.P. Morgan Securities LLC was

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the book-running senior manager, and Coastal Securities, Inc., Goldman, Sachs & Co., Stifel, Nicolaus & Co., and Frost Bank were the co-managers.

In preparation of the transaction, the EA's staff evaluated the underlying cash flows and the DFund loan commitments, taking into account cost of funds and cash flow coverage ratios when determining the optimal amortization structure for the Subseries 2016B-1 bonds, which provided the new money portion of the transaction. The bonds sold to provide funds for state match requirements, in particular for the DWSRF, were structured to provide a short ten year amortization with some principal frontloaded for the DWSRF in order to minimize stress on coverage ratios, and to align DWSRF borrower interest payments with bond debt service.

For the remaining refunding portion of the transaction, staff performed an analysis of the compliance with Tax Increase Prevention and Reconciliation Act (TIPRA) requirements for the bonds proposed to be refunded in order to determine whether the bonds could be refunded on a tax-exempt basis. Tax counsel reviewed and concurred with the TIPRA analysis performed by staff.

Additionally, staff evaluated the prepayment risk related to the call date options for the underlying borrower loans. The purpose of this analysis was to integrate flexibility to reduce prepayment risk while still achieving debt service savings. Based on this analysis and given the history of prepayments in the TWDB's general obligation bond programs, the Plan of Finance was developed to include the utilization of soft put bonds, and fixed rate bonds with six year call options to provide the TWDB a more flexible alternative to applying prepayments when received. Soft put bonds typically have a long-term stated maturity with a low interest rate, but are required to be redeemed or remarketed within a few years of their issuance, and if the issuer fails to do so, the bonds "step up" to a much higher interest rate until they are refunded. The Plan of Finance incorporated a balanced composition of fixed rate bonds and soft put bonds to strive for a structure that minimizes interest rate risk while allowing an alternative to accommodate borrower prepayments.

BOND PRICING

Pre-pricing events were scheduled to occur on Friday, June 24. However with the results of the United Kingdom's Brexit vote having just occurred the previous day, there was a market shock, impacting the ability to perform price discovery. The decision was made to postpone discussions until the following Monday. On Monday, although there was still significant market volatility, J.P. Morgan worked to establish preliminary pricing levels on both the tax-exempt and taxable bonds. Given the market volatility and further reduction to an already historically low interest rate environment, investor pushback was noted which resulted in a widening of credit spreads. This is where much of the pre-pricing focus and discussion occurred.

The results of the pricing were very positive. Strong investor interest in the soft put bonds resulted in those bonds having a subscription rate of five times, which allowed the TWDB to reduce the yield on the bonds by five basis points. On the remaining tax-exempt bonds, there was generally positive investor interest, resulting in bonds having an approximately two times subscription rate and allowed the TWDB to reduce the credit spreads on the bonds by two to four

basis points. There was also substantial interest in the taxable bonds, with a subscription rate of six times which led to across the board reductions in credit spreads from the time of initial solicitations of interest. However, J.P. Morgan did underwrite approximately \$32 million in bonds as certain maturities of bonds remained unsold due in part to their call features and term.

RESULTS

The Water Financial Assistance and Refunding bonds, Series 2016BCD provided \$52,740,299 of new money proceeds and refunded \$114,180,000 of the TWDB's bonds. The issuance produced total net present value savings of \$19,657,172. The All-in True Interest Cost (TIC) of 2.06% reflects the very low cost of borrowing secured by the TWDB, which will be passed along to tax-exempt borrowers receiving financial assistance from the DFund with an appropriate adjustment for the TWDB's costs.

Key statistics of the transaction are shown in Table 1 below.

Table 1

Subseries	Tax Status	Program	Par	Premium	NPV Savings \$	NPV Savings (%)	TIC
2016B-1*	Tax-Exempt	DFund	\$ 58,555,000	\$ 10,301,263	\$ 2,037,402	12.92%	1.32%
2016B-2**	Tax-Exempt	DFund	\$ 30,360,000	\$ 331,228	\$ 5,099,417	16.73%	1.93%
2016B-3	Taxable	DFund	\$ 18,950,000	\$ -	\$ 2,869,371	15.14%	2.01%
2016C-1	Tax-Exempt	EDAP	\$ 28,815,000	\$ 5,243,193	\$ 5,736,980	16.92%	1.20%
2016C-2	Taxable	EDAP	\$ 1,310,000	\$ -	\$ 190,029	14.51%	1.75%
2016D	Tax-Exempt	SP	\$ 11,550,000	\$ 2,307,358	\$ 3,723,974	27.03%	3.29%
Total			\$ 149,540,000	\$ 18,183,041	\$ 19,657,172	17.22%	2.06%

*Subseries 2016B-1 included new money and refunding proceeds

**Denotes soft put bonds

The savings noted above will change if the put bonds are called prior to their mandatory tender date in three years, which is reasonably likely as prepayments on the underlying loans are expected to be received and used to redeem bonds. Additionally for purposes of illustration, the soft put bonds have been assumed to be remarketed at a 2.00% rate.

In addition to achieving a low cost of funds for new bond proceeds, and the savings outlined above, the TWDB was successful in achieving other goals related to the transaction. Soft put bonds were issued with a one year par call, and the SP bonds and taxable DFund bonds were issued with a six year par call. The shorter calls provide additional flexibility relative to potential prepayments. The use of proceeds to reimburse the TWDB for loans already originated reduces efforts needed to meet TIPRA requirements. Debt service on the new money bonds was structured to meet the demands of committed borrowers, and to minimize the impact to the SRFs from the state match funds provided. Debt service on the refunding bonds was structured to provide generally level savings.

COST SUMMARY

The final cost was \$3.43 per bond, negotiated as follows:

	<u>\$ Per Bond</u>	<u>Total \$ Amount</u>
Average Takedown	\$3.08	\$460,160
Underwriter's Expenses	<u>0.35</u>	<u>52,543</u>
Total Spread	<u>\$3.43</u>	<u>\$512,703</u>

PERFORMANCE ASSESSMENT

In general, the TWDB was pleased with the performance of the underwriting syndicate on the refunding and new money transactions. J.P. Morgan led the transaction well, especially with the market volatility at the time of pricing. The TWDB was particularly pleased to see that Coastal, Stifel, Nicolaus and Frost Bank supported the transaction by turning in priority orders. Each of those firms received allotments of bonds based on a portion of those orders. Additionally, Coastal, Stifel Nicolaus and Goldman were allocated bonds based on meaningful member orders.